



**From Reform to Retreat:  
30 years of Australian  
fiscal policy**

**Robert Carling**



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**TARGET30**  
REDUCING THE BURDEN FOR  
FUTURE GENERATIONS

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# Foreword

The Hon. Peter Costello

Most policy-makers would agree that in times of recession it is natural and beneficial for a Government to run a Budget deficit. After all, in a recession people are thrown out of work and tax collections decline. People out of work draw down on the social safety net, and expenditures increase. As an economy grows out of recession this process should reverse – these natural stabilizers should unwind and improve the Government’s financial position, bringing the Budget back to balance.

But what do you do if an economy, years out of recession, is growing strongly and the Budget continues to haemorrhage? If a Government is running deficits in years of plenty, imagine how those deficits will magnify if the economy goes into downturn. If a Government is borrowing in good times, then it will be borrowing much more in lean times. A country that is perpetually borrowing — throughout the economic cycle — is asking for trouble. And it will come, eventually.

This was the challenge I faced when I became Australian Treasurer in early 1996.

We had been through a recession in 1991. The Budget went into deep deficit. As economic growth took off, the Government promised it would bring the Budget back into balance. After several years of strong growth, the Government forecasted a Budget surplus in 1995 and all the following years of projections. But it was a very liberal and creative accounting regime. When I took office there was no surplus, we were facing our seventh consecutive Budget deficit, at around 2 percent of GDP. Without corrective action these deficits would have continued into the 2000s.

In my first Budget Speech I put it like this:

Our predecessors had Australia on a path of deficit and debt to the next century. Make no mistake, this path would only make future choices harder, future possibilities bleaker and rob Australians of the future opportunities they deserve. Our Government could not stand back and ignore the problem. Although we did not create it. We will take responsibility to fix it.

We set out a two-year plan to balance the Budget and to do it principally on the expenditure side. Over two years we cut expenditure by 1.7 percent of GDP, and revenue increased 0.4 percent of GDP. Cutting expenditure was not popular. But we called on the public to come on the journey with us and promised it would, in due course, produce results.

Apart from defence, which was already badly run down, no area of spending was quarantined from spending reduction. We tried to share the burden equitably. We asked all sectors to make their contribution.

One of the key things that helped was a clear explanation of the nature of the problem. People will not support difficult and tough measures just for the sake of it. They might support them if they think they are necessary. But you will have to convince them that they are necessary, and convince them that they will solve a real problem. A doctor has to diagnose a patient before the patient can understand what the treatment is all about and co-operate with it. And, of course, the treatment has to be the right one to cure the illness.

Our point was that if the Government was rapidly running up debt in the good times it would find itself awfully exposed in the bad times. Younger Australians saddled with debts run up by their parents were going to inherit less opportunity. Their taxes would be higher – not to buy services for themselves and their own generation – but to pay the bills their parents had never bothered to fund. It would be a very bad form of inter-generational transfer for those who took the services in our generation to bequeath the taxes to pay for them to the next.

And so we set out our goal – to balance the Budget on average over the course of the economic cycle. This meant that when the economy

was growing strongly the Budget would be in surplus and we would pay down debt. If we could get the Budget in balance and debt under control, the Government wouldn't need as much tax-it could cut taxes. If taxes were reduced the economy would grow stronger and the virtuous cycle continue.

We set ourselves the task of balancing the Budget in our first term of government. In our second term we set ourselves the task of reforming and lowering tax. We introduced a GST, and abolished seven pre-existing indirect taxes. We cut Income Tax, Company tax, and Capital Gains tax. By our fourth term we had repaid the Commonwealth Government's debt in net terms. We established a Sovereign Wealth Fund- the Future Fund- to invest future Government surpluses.

From 2006, the Government debt to GDP ratio was better than zero. In fact, we had a negative debt to GDP ratio because of the assets we held in the Government owned Future Fund.

During this period of Budget repair, Australia's sovereign credit rating was upgraded twice to its current AAA-level.

Over the twelve Budgets I delivered, there were ten surpluses. And then, in 2007, our Government was voted out of office. We had been in office nearly twelve years. The public thought it was time for a change. Maybe they thought balanced budgets and tax cuts would continue to deliver themselves.

In 2008, the international financial system experienced great strain. Many countries went into recession. Australia did not. No major Australian bank failed. In fact, no major Australian bank experienced even a quarterly loss, let alone an annual loss. The Government unleashed a lot of fiscal stimulus. With such a strong Balance Sheet it had the means to do so.

As a result of that stimulus, in 2009 the Australian Budget went back into deficit. Although Governments of both political persuasion have promised to rectify the situation, it has remained there ever since. We have had ten Budget deficits since the massive fiscal stimulus that nicely match the ten previous surpluses. All the debt that was paid off when I was Treasurer has been borrowed back again.

People often ask whether it was worth paying off the debt given that subsequent Governments have gone out and borrowed it all back.

The only answer I can give is to say: just imagine where we would be if we hadn't paid off that debt? Sure, subsequent Governments have piled on debt, but if we hadn't got the Commonwealth debt free, they would have piled debt on pre-existing debt rather than debt against a strong asset position.

Even today Australian Government net debt is much lower than comparable countries. Our fiscal journey over the last ten years has been bad. But our starting point was extremely strong. It was the starting point that gave us the ability to weather the 2008 storm.

We still have a lot of other things to show from the strong fiscal management of previous years. We have a system of transparency in financial reporting that is second to none. This is prescribed by law under the Charter of Budget Honesty. As I have said, our Balance Sheet is comparatively strong because we went debt-free from 2006. Although memories dim, the public remembers the days of balanced Budgets not as a horror time, but as a period of great success. Most Australian politicians still pay lip-service to the policy of balancing the Budget over the course of the economic cycle. And we have a Future Fund.

No Government can expect to bind its successors. The argument for strong fiscal policy has to be mounted again in each election and in each generation. But successful prior experience should encourage those now engaged in that argument, that the public will support a well-designed program and it can be successful.

**Hon. Peter Costello was the Treasurer of the Commonwealth of Australia, 1996-2007.**



## **PREFACE**

This review of Australia's fiscal reforms over the last 30 years was written at the request of the Macdonald Laurier Institute of Canada as one chapter of a multi-country study of the experience with fiscal reform in the 'Anglosphere' (also including the United Kingdom, Canada and New Zealand). The project, jointly with the American Enterprise Institute, is intended to inform the debate on fiscal reform in the United States.

Although Australia has an impressive reform story to tell, the reality is that fiscal performance has more recently deteriorated. The Centre for Independent Studies is publishing the Australian review in this Occasional Paper as — quite apart from the overseas interest in Australia's experience — it is important for Australians to take stock of the history of fiscal reforms when so much of what has been achieved is now at risk of being reversed.

The chapter has been slightly modified for an Australian readership, but is essentially the same as that published by the Macdonald Laurier Institute in November 2017. Readers should note that consistent with the specifications of the project, the review is confined to the federal government's fiscal reforms. The omission of state governments is deliberate and is not a denial of their own fiscal reforms over the same period.



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## INTRODUCTION

Australia has been described in recent decades as a ‘miracle’ economy because of the longevity and strength of growth, absence of recessions, and the degree of improvement on the country’s prior economic performance.<sup>1</sup>

Miracles come from supernatural forces, and there has been no miracle in Australia, but certainly for much of the past 30 years Australia has out-performed other advanced economies thanks to a combination of its economic policies and favourable external shocks. The starting point is somewhat arbitrary, but there was a decisive break in economic policies in the mid-1980s that began the reform path, even though the actual improvement in economic performance did not become apparent until some way into the 1990s.

This charting of a new path in economic and fiscal policy was by no means inevitable. It reflected choices by Australian policymakers to liberalise the country’s economy and strengthen its public finances. A new multi-partisan consensus was formed in favour of markets and disciplined spending. Australia has indeed reaped the benefits ever since.

There is, however, evidence of growing complacency and reform fatigue in Australia, including backsliding on fiscal policy. Abandoning the policy course that has served the country so well for the past 30 years would be foolhardy.

The purpose of this essay, then, is to describe the economic and political circumstances that led to this new policy course, to detail and analyse the composition of Australia’s fiscal reforms, and to highlight the economic and social outcomes associated with them. The goal is not only to remind Australia’s policymakers of the success of its economic and fiscal reforms, but also to share this experience with an international audience as policymakers in other countries grapple with how best to deal with their budgetary problems.

## WHY FISCAL REFORM?

The long history of under-performance up to the 1980s was reflected in sluggish economic growth; weak productivity growth; slippage in living standards relative to other advanced countries; relatively

high inflation; union-led strife in the workplace; high tariff barriers and other forms of protection; low domestic saving; excessive fiscal deficits; and an inefficient tax system. Why these problems were not addressed earlier is an issue for the political scientists. Suffice it to say that a new Labor government elected in 1983, and re-elected in 1984, resolved to tackle the malaise and had the broad support of the Liberal-National parliamentary opposition, which in turn continued the reform approach when it came to government in 1996.

Economic performance improved noticeably after a severe recession in the early 1990s, with low inflation becoming entrenched; a period of strong productivity growth; a return to unemployment levels not seen since the early 1970s; fiscal surpluses; and the elimination of general government net debt. There has been no recession (on the admittedly deficient mechanical definition of two consecutive quarters' decline in real GDP) since 1991 — setting a new record for advanced economies — although on other definitions there was a mild recession coinciding with the global Great Recession of 2008–2009<sup>2</sup>. Australia has progressed up the international economic league tables.

However, these successes are of course not only attributable to Australia's own reform efforts. As a major exporter of minerals, Australia benefited hugely from China's industrial revolution. After a long period in the doldrums, Australia's terms of trade index doubled from the early 2000s to a peak in 2011. This, combined with earlier policy reforms, helped generate the largest improvement in living standards (over a relatively short period) since the gold rush boom of the colonial 1850s.

More recently, prosperity has bred complacency and reform fatigue, and the forces of populism evident in other countries are influencing public policy in Australia too. Fiscal performance has deteriorated markedly since 2007. It remains to be seen whether Australia learns from other countries' failures and returns to the reform path, or itself becomes a case study of failure to adjust.

The earlier reforms did not consist of a single roadmap but evolved over time. At different times they included liberalisation of the exchange rate and capital flows; domestic financial deregulation; changes in the conduct of monetary policy; deregulation of the labour market including workplace relations; industry policy including protection;

competition policy for goods and services markets; retirement incomes policy; education and training; and fiscal policy including fiscal federalism and privatisation of state-owned enterprises.<sup>3</sup> This paper is confined to an examination of the fiscal reforms, while recognising the importance of other reforms.

Australia is constituted as a federation with a central government and six sovereign states. The central government is the dominant fiscal power — particularly in taxation — and makes large transfers to the states (vertical fiscal imbalance being very high). In the interest of consistency with other papers in the Anglosphere project, the focus here is on central government fiscal policy. This is not to deny that states also have undertaken fiscal reforms of their own.

## **OVERVIEW OF FISCAL REFORMS**

The fiscal reforms undertaken since the mid-1980s fall into six thematic categories:

- (i) Institutional: use of fiscal rules and targets; lengthening the time horizon of fiscal policy; legislated framework for fiscal policy; accounting and financial management changes; establishment of a sovereign wealth fund; and establishment of a Parliamentary Budget Office.
- (ii) Management of the fiscal balance and public debt: bringing the budget into balance; use of deficits and surpluses in economic management; reducing general government net debt.
- (iii) Expenditure management: controlling the government spending growth rate and share of GDP; and specific measures taken towards this objective.
- (iv) Taxation: use of tax policy changes in short-term economic and fiscal management; longer term reforms; and policies on the overall tax burden and size of government
- (v) Efficiency of resource allocation: privatisation and corporatisation of state-owned enterprises; measures to improve efficiency in the general government sector.
- (vi) Fiscal federalism: reform of general and tied grants to the states; participation of states in national tax reform.

The following sections expand on each of these categories.

The objectives of fiscal reform have evolved over time from an initial emphasis on reducing the fiscal deficit to help bolster national saving, reduce the external current account deficit and bring inflation under control. Later there came a stronger emphasis on privatisation and corporatisation both to raise revenue and improve the efficiency of resource allocation in the economy. Deficit and debt reduction became prominent again after a blow-out resulting from the early 1990s recession.

In the 2000's the emphasis turned to management of the revenue windfall and fiscal surpluses resulting from the China-driven resources boom. In 2008 the emphasis shifted abruptly to fiscal stimulus as a means to soften the blow of the global Great Recession, and new social spending programs were added by the Labor government. These developments together with the fading resources boom produced a structural fiscal deficit and the emphasis has once again (but so far largely unsuccessfully) turned to reducing the deficit and public debt.

Throughout the past 30 years, the imperative of tax reform has come to the fore on several occasions, prompted by considerations of economic efficiency, equity, international benchmarking, long-term revenue performance and deficiencies in fiscal federalism.

### ***1. Institutional and fiscal governance reforms***

There has been little interest in 'large C' constitutional changes in support of fiscal reform (such as a balanced budget amendment), as governments and their advisers shun the rigidities that constitutional constraints would impose on them. In any case, as a practical matter it has proven very difficult to amend the Australian Constitution. There have, however, been other changes to the legal and institutional basis of fiscal policy.

- (i) The use of fiscal rules and targets. At various times — usually when fiscal consolidation was needed — governments have adopted quantitative fiscal rules and targets to signal their commitment to fiscal adjustment in a medium-term framework and to steer the type of adjustment in their preferred direction. These rules and targets have been self-imposed by executive



government, have not been legislated, and are not subject to any enforcement mechanism other than public opinion.

For example, in the 1980s there was a 'trilogy' of quantitative constraints on the deficit and both tax revenue and expenditure as proportions of GDP. However, there has been a lack of consistency in the nature of these rules and targets over time. The most enduring and bipartisan has been the commitment to balancing the budget on average over the business cycle, which more recently has evolved into achieving a surplus (unquantified) on average over the cycle. There was a legislated debt ceiling for a time, but it was abolished in 2013.

- (ii) The Charter of Budget Honesty was legislated in 1997 to provide a framework for fiscal transparency and discipline — and this legislation has bipartisan support and remains in force. However it contains no fiscal rules or targets. Rather, it sets out broad principles for the conduct of fiscal policy and requirements for fiscal reporting.
- (iii) A longer-term horizon for fiscal policy. Four-year budget forward estimates were adopted in the 1980s to demonstrate the medium-term consequences of current expenditure and revenue policies. The abovementioned Charter of Budget Honesty introduced a requirement for 'intergenerational reports' at five-year intervals. These reports take a 40-year forward view of the budget based on existing policies, attract as much public attention as annual budgets, and have influenced policies such as those shaping the impact of population ageing on government expenditure.
- (iv) Accounting and financial management changes. Australia was one of the first countries to adopt accrual accounting in the public sector (in the late 1990s). This focused greater attention on the public sector balance sheet and limited opportunities for the government to distort annual budget results by arbitrarily shifting cash flows across years. However, while accrual-based results are published, the government continues to emphasise the cash budget result in its reporting.

- (v) Establishment of the Future Fund in 2005. This fund, although in essence the same as a sovereign wealth fund, was set up to match the liabilities of the unfunded pension plan for civil servants. Injections to the fund came from privatisation proceeds and, to a lesser extent, budget surpluses. Creation of the fund may have made budget surpluses politically easier to sustain. There have been no new injections since 2007, but through investment returns the fund has grown to around \$A130 billion, which still falls short of fully funding pension liabilities. While it was desirable to reduce the unfunded pension liability, in broader terms there are arguments against sovereign wealth funds — for example, the available funds would be better used to finance productivity-enhancing tax cuts or infrastructure projects.<sup>4</sup>
- (vi) Establishment of a Parliamentary Budget Office (PBO). This was created in 2012 to add a more independent voice to fiscal policy processes. In its own words, the PBO's purpose is to “inform the Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals”.<sup>5</sup> Unlike its UK counterpart, however, the PBO plays no direct role in the preparation of the budget, such as in determining the macroeconomic assumptions underlying budget estimates.

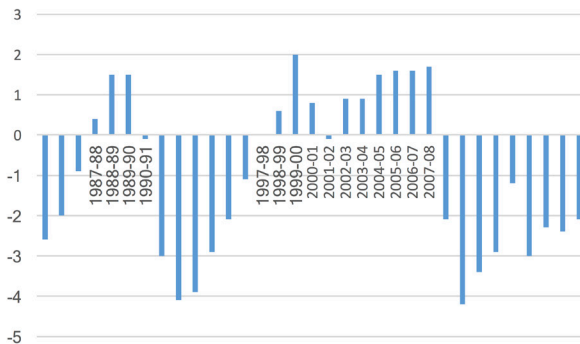
It is difficult to say what difference these changes to institutional and fiscal governance arrangements have made to actual fiscal outcomes. Certainly it can be said that budget procedures, documentation and transparency have improved greatly and are now among the best in the world. Governments with a weak fiscal record have nowhere to hide. While these improvements supported an improvement in fiscal performance up to 2007, they have not prevented a serious weakening since then. Strong fiscal institutions and governance arrangements are an essential foundation of good fiscal policy, but they cannot compensate for a lack of political resolve in addressing underlying fiscal problems.

## 2. Management of the fiscal balance and public debt

Fiscal consolidation — achieving balanced or surplus budgets and keeping public debt low — has been a regular theme of fiscal policy. As noted above, the most consistent fiscal rule has been maintenance of a balanced or surplus budget on average over the business cycle. The record of achievement against that benchmark is mixed.

As Figure 1 illustrates, the deficit has been low by international standards, both on average and at its cyclical peaks, averaging 0.8% of GDP in the 30 years to 2016, 0.6% in 20 years, and 1.8% in the past 10 years.<sup>6</sup> It could also be said there was an improving trend, with the 10-year average dropping from a deficit of 1.6% in 1986 to 1.2% in 1996 and a surplus of 0.7% in 2006. However, the trend has subsequently been reversed, with the 10-year average rising to a deficit of 1.8% of GDP in 2016.

Figure 1: Federal Budget Balance  
(% of GDP, 1985 - 2017)



The long-standing rule of balancing the budget, on average, over the business cycle has not been achieved. It is true that 11 consecutive years of balanced or surplus budgets up to 2008 gave the appearance that the rule was being achieved, but in fact that period featured continuous economic expansion and high commodity export prices rather than a business cycle. The expansion was interrupted by only

minor slow-downs in growth and was fuelled by Australia's largest ever resources boom, which supercharged tax revenue growth to 8% a year in the five years to 2007–08.<sup>7</sup> Since the boom ended, revenue has been repeatedly written down and sizeable budget deficits have prevailed, more than offsetting the preceding run of surpluses. Over a long period including both boom and bust the budget has been in deficit on average (for example, an average of 1% of GDP in the period 2002–2017).<sup>8</sup>

The negative side of this mixed record stems from the fiscal consequences of a severe recession in the early 1990s and the global financial crisis of 2008–09. In each case, the operation of automatic fiscal stabilisers inflated the deficit and was reinforced by discretionary fiscal stimulus. The stimulus was particularly aggressive in response to the global crisis of 2008–09, with Australia registering an above-average dose of stimulus among G20 countries.<sup>9</sup> Both episodes represented a departure from previous official statements that fiscal policy should maintain a medium and long-term focus and not be side-tracked by short-term macro-economic stabilisation considerations. In each case the budget swung from surplus to deficit by around 6 percentage points of GDP in two or three years to a peak deficit of around 4% of GDP (Figure 1). Following the typical asymmetric pattern of discretionary fiscal stimulus, part of what was intended to be temporary became structural and the unwinding of the inflated deficit was slow until concerted consolidation efforts began.

While it is generally accepted that automatic fiscal stabilisers should be allowed to work, the wisdom of discretionary fiscal stimulus — particularly the large dose applied in 2008–09 — remains hotly debated. The Australian economy held up relatively well during the global crisis, but other favourable influences at the time may account for that outcome. Proponents say the stimulus was justified by the scale of the threat from the global crisis and that fiscal multipliers were large enough for the stimulus to provide significant support to economic activity and employment. Others argue that any stimulus was largely offset by other variables such as interest and exchange rate effects, the multiplier was close to zero, and the stimulus comprised wasteful measures and put the budget onto an unsustainable path to

higher public debt in the context of Australia's high household debt and foreign debt.<sup>10</sup>

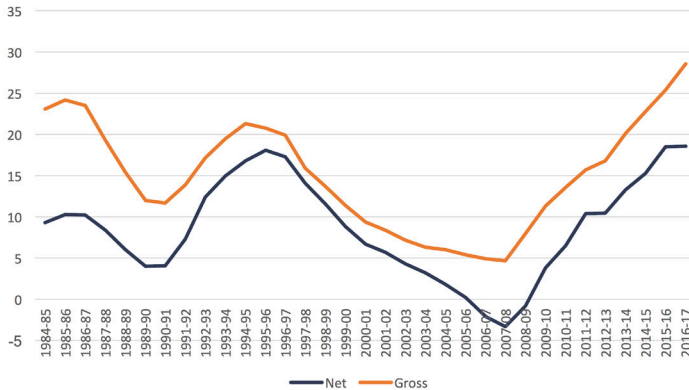
The positive side of Australia's fiscal record can be seen in past episodes of successful fiscal consolidation — or what is now called 'austerity'. In the late 1980s and again in the late 1990s the deficit was reduced by around 3 percentage points of GDP through discretionary policy action particularly on the spending side of the budget. Further discussion of how this was done follows in the next section, but it is worth noting here that contrary to the fears often expressed by opponents of consolidation, it did not drive the Australian economy into recession or even produce a growth slow-down of any significant size.<sup>11</sup> A recession did follow the 1980s episode, but that is attributable to a severe tightening of monetary policy and adverse shocks from abroad.

Those earlier episodes of successful consolidation have not been repeated after the latest deficit blow-out following the global crisis of 2008–09. The deficit has come down, but remains elevated seven years after the peak and, under current policies, is projected to continue for several more years. By the same point in previous cycles, the budget was balanced or in surplus, thanks to policies of consolidation. This time, a small surplus is projected for 2020–21, but there are serious doubts as to whether this will actually be achieved, and if it is, whether it can be sustained for long. The challenge may have been larger this time — due to weaker economic growth, slumping commodity export prices and a slow automatic recovery in budget revenue — but consolidation efforts also have been weaker. Particularly telling has been the failure to make a dent in elevated levels of federal spending sufficient to close the budget deficit. Stimulus-level spending was partly unwound, but this emphasis quickly gave way to renewed spending of a more permanent kind.

The long-term challenges are clearly set out in the government's latest Intergenerational Report (2015), which maps fiscal projections over a 40 year horizon. The report shows the budget position improving under then legislated policies until around 2023, then deteriorating continuously so that by 2055 the deficit would be 6% of GDP and net debt 60% of GDP.

In contrast, and despite the deficits of recent years, federal debt is currently low by international standards with general government gross debt at around 29% of GDP and net debt at around 19% (Figure 2).<sup>12</sup> However, if the current level of debt appears manageable, this reflects a favourable starting point<sup>13</sup> rather than the trend of recent years, which has been emphatically unfavourable. The relatively low level of debt reflects the history of low deficits discussed above and the retention of privatisation proceeds as financial assets. Cyclically, debt has fluctuated and reached a peak of 18% of GDP (net debt) in the 1990s before fiscal consolidation reversed the increase and now again stands near 18%. Further increases appear certain, with a peak of 20% of GDP currently projected by the government for 2019, which the recent track record suggests is more likely than not to be exceeded. It is not so much the current level of debt that is worrying, but its upward trajectory under current policies. While Australia remains among a handful of governments with a triple-A credit rating, one rating agency has now qualified this with a negative outlook pending the government's future actions to curb the deficit and growth in debt.<sup>14</sup>

Figure 2: Federal Debt  
(per cent of GDP, 1985-2017)



Policy constraints on the growth of debt have been relaxed recently as the federal government has taken a more expansive approach to infrastructure spending in the belief that at least some debt incurred for such investments is sustainable whereas debt incurred to finance recurrent deficits generally is not. Although direct capital spending by the federal government is quite limited (mainly defence equipment), the government makes grants to the states and injects debt and equity funding into its own business enterprises for capital purposes. Taking all these forms of capital commitments together, they are projected to increase by around \$11 billion a year on average in the four years ending in 2019–20 compared with the preceding four years.

This policy shift in favour of capital expenditure is open to criticism on several grounds. It downplays the fact that much of the existing federal debt reflects past recurrent deficits and that the recurrent budget remains in deficit today. This deficit needs to be corrected before consideration is given to increasing debt for capital expenditure reasons. Even then, the quality of proposed infrastructure spending and its contribution to future economic growth needs to be carefully examined.<sup>15</sup> In practice, some infrastructure spending is undertaken for political reasons and would fail a rigorous cost/benefit analysis.

### ***3. Expenditure policy***

Australia has big government, even if it is not as big as in some other developed countries where government spending exceeds 40% or even 50% of GDP. In Australia, the proportion stands at around 37% for all levels of government combined,<sup>16</sup> of which some three-quarters is financed by the federal government either directly or indirectly via transfers to lower tiers of government. The welfare state is as extensive as in other developed countries and social benefits are as generous, but the cost is more contained because benefits are more tightly targeted by means testing and other eligibility criteria. Moreover, private savings make a major contribution to retirement incomes through a system of compulsory, tax-favoured private retirement accounts. These features have kept the public sector below 40% of GDP.

The familiar forces behind the long-term growth in the size of government in many countries are also evident in Australia.

Expenditure policy reflects the tension between these forces and the pressure to limit the tax burden and budget deficits. Pressures to increase spending through new programs and widening of existing programs are always present, while the countervailing forces tend to come into play only when the budget deficit becomes problematic. To the extent growth in government spending has been held in check, it is more because of resistance to excessive deficits and tax increases than any widely held belief in the benefit of smaller government.

Three key episodes can be identified since the 1980s when concerns about a deterioration in the fiscal position have focused attention on excesses in federal spending. First, in 1985 federal spending reached the peacetime record level of 27.6% of GDP amid concerns about the fiscal deficit, the external current account deficit and exchange rate weakness. Second, in the mid-1990s a newly elected government — having campaigned on the need to reduce a persistent deficit and reverse the rise in public debt — resolved to attack the problem mainly through spending curbs. Third, since the large fiscal stimulus of 2008-09 and subsequent persistent weakness in tax revenue, successive governments have aimed to slow the growth in spending in order to curb persistent deficits. The first two episodes were examples of successful fiscal consolidation through spending cuts, but the third has been largely unsuccessful.

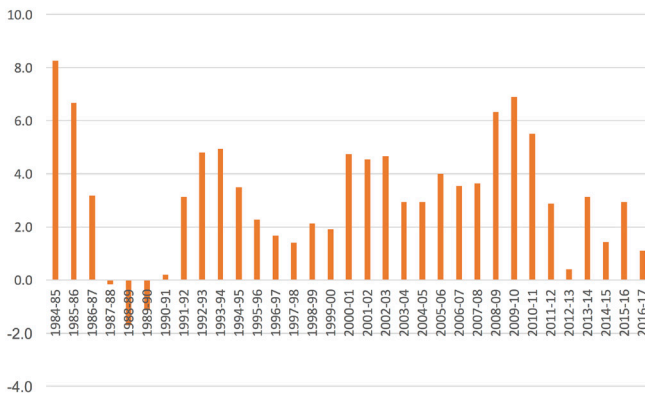
When the need for cuts has overcome the urge to spend more, the particular measures have covered a wide range and it is difficult to generalise. However, the following list provides some examples:

- Tightening of eligibility criteria for social benefits — for example, a tighter means test and increases in the minimum retirement age for the public pension.
- Pauses in indexation of social benefits such as family allowances.
- Periodic intensified culling of ineligible recipients from the ranks of social security beneficiaries.
- Cuts in defence spending, which was 2.2% of GDP in the early 1990s but fell as low as 1.7% in recent years.
- Cuts in foreign aid, which was as high as 0.5% of GDP in the mid-1980s but is now less than half that level.



- Reductions in discretionary grants to the states.
- Efficiency dividends. These are annual clips from the budgets of most departments, and are meant to replicate the pressure for productivity gains in the private sector.
- Reductions in the size of the public service, though not in pay or benefits apart from the defined benefits pension scheme, which has been replaced by a cheaper accumulation scheme for new entrants.
- Increased or new charges, such as the introduction of university fees in the 1980s accompanied by an innovative income-contingent government loan scheme (HECS) which enables students to defer payment (via the tax system) until their annual earnings reach a certain level.

Figure 3: Federal Budget Spending,  
3-year moving average real % change

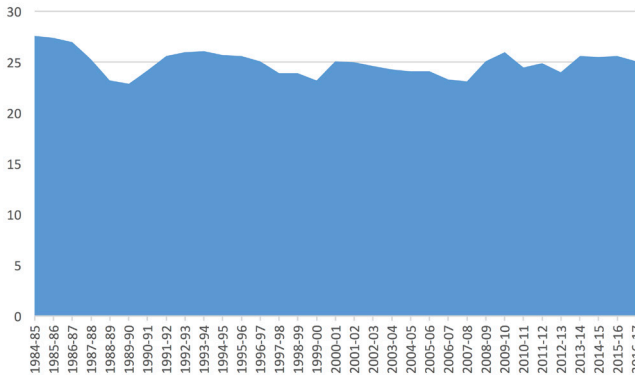


This is not to suggest that every cut has been permanent. Sometimes they have been politically or otherwise unsustainable, such as the cut in defence spending, which is being restored to 2% of GDP.

As Figure 3 illustrates, the 1980s episode of spending restraint was the most successful, achieving an absolute reduction in federal

spending in real terms, while the 1990s episode severely curbed the rate of growth in real spending for a few years. In each case, there was a significant reduction in the proportion of federal spending in GDP (Figure 4). As a result of this pattern of growth in government spending followed by periods of restraint, the proportion of spending in GDP in the early 2000s was lower than in the mid-1980s. Subsequently it has tended to increase again due to the long period of ample revenue growth generated by the resources boom, the fiscal stimulus of 2008–09, and more recently the introduction of new social spending programs.

Figure 4: Federal Budget Spending  
% of GDP, 1985 - 2017



The most recent episode warrants closer attention as it represents a departure from the past pattern of a fiscal weakening forcing strong spending restraint. On this occasion, the forces for expenditure discipline have been much weaker. While some spending curbs have been put in place, at the same time new programs in disability care, school education and child care have been rolled out, while public expenditure on health continues to grow faster than other programs on average — and faster than GDP. The government’s stated objective has been to reduce spending, but its position in the parliament has been weakened by recent election results which rendered it unable to

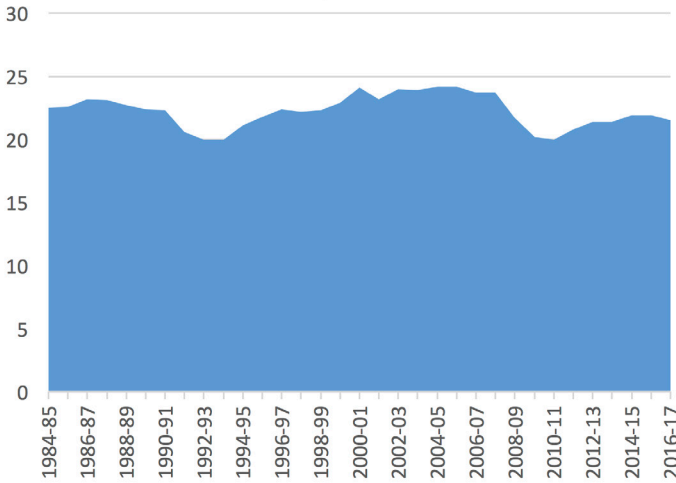
secure parliamentary approval of many expenditure savings measures in the upper house. Even the measures it has put forward but failed to implement would not have been sufficient to close the budget gap. It has not prosecuted the case for spending restraint well, in the face of well organised and effective public campaigns to protect existing programs or promote new ones. The budget for 2017–18 suggests the current government has largely surrendered to these forces and retreated from expenditure restraint, with expenditure in real terms rising by more than 2% a year and maintaining its proportion of GDP.

Government expenditure outcomes have undoubtedly been influenced by the politics of inequality and populism that have been evident in other countries. Even though Australian inequality is unexceptional by international standards and has not significantly changed in recent times, the world-wide movement against inequality has reached Australia, and the perception that it is a major issue has spread without much attention being paid to what the statistics reveal.<sup>17</sup> The largest potential expenditure savings tend to have a disproportionate impact on lower and middle income households and it is therefore difficult for governments to win wide support for them. Increasing taxes has proven politically easier, particularly if the impact is concentrated on big business, multinationals and individuals with above average incomes.

#### **4. Tax policy**

Federal tax revenue as a share of GDP has risen strongly over the long-term (as has the public sector total, of which federal revenue comprises over 80%). There was a particularly rapid increase in the 1970s and early 1980s, which has not subsequently been reversed. Since the mid-1980s the share has fluctuated around an average of about 22% of GDP with no clear trend (Figure 5). When the ratio has risen above the average, pressure for tax relief has intensified, as in the mid-1980s when it reached 23% and in the 2000s when it reached 24%. On both occasions there were extensive changes to tax policy, as discussed below. The current government says it will cap the ratio at 23.9%, which on current projections will be reached in 2022.

Figure 5: Federal Tax Revenue  
% of GDP, 1985 - 2017



Fluctuations in the tax/GDP ratio reflect the economic cycle, but tax policy changes are of more interest to us here. While there have been many policy changes, they have not normally been made for counter-cyclical purposes — rather, revenue weakness in recessions and strength in booms has reflected the elasticity of revenue in relation to tax bases and the automatic growth of personal income tax revenue in response to inflation in a non-indexed, progressive tax rate scale (the ‘bracket creep’ phenomenon). Policy changes have usually been motivated by one or more of the following objectives:

- Relieving built-up pressure of bracket creep, which automatically lifts average income tax rates;
- Reducing imbalances in the composition of tax revenue, particularly the excessive reliance on personal and corporate income tax which has long been a feature of the Australian tax system;
- Maintaining or improving the international competitiveness of Australian taxation, particularly corporate and personal income tax;

- Improving economic efficiency and horizontal equity by broadening tax bases and closing gaps and loopholes;
- Strengthening federalism by using federal policy levers to improve the states' revenue bases; and
- Managing budget deficits and surpluses.

Such considerations have at times led governments to launch tax reform initiatives based on major reviews of the tax system, leading to bursts of policy changes. This happened in the 1985–89, 1999–2000 and 2003–07 periods.<sup>18</sup>

In 1985, the focus was on reducing high marginal rates of personal and corporate income tax, updating personal tax thresholds, and paying for these changes in part through base-broadening such as introduction of a capital gains tax and a fringe benefits tax and reductions in business depreciation allowances. The top marginal personal rate was reduced in stages from 61% to 48.5% and the corporate rate from 46% to 39% (Figures 6 and 7). To a significant degree, Australia was playing catch-up with an international trend towards lower marginal rates that had started several years earlier.

In 1999, personal income tax was again reduced (both by cutting marginal rates and updating thresholds), the corporate rate was cut in stages to 30% and a value-added tax (Goods and Services Tax or 'GST') was introduced at a rate of 10% to replace a narrowly-based wholesale sales tax and a number of inefficient state financial transactions taxes. Although broad-based by comparison with the sales tax it replaced, the GST itself provided substantial exemptions (such as for unprepared food, water, education and health services) which took the effective coverage of household consumption expenditure to around 50%.

Beginning in 2003, and in the context of strong revenue growth from the resources-fuelled boom, concerns that personal income tax remained too high were addressed in a series of reductions in marginal rates and large increases in bracket thresholds concluding in 2010. This brought the top personal rate down to 46.5% and lifted the threshold for that rate from \$60,000 to \$180,000.<sup>19</sup> However, there was no further reduction in the corporate rate.

Figure 6: Corporate Income Tax Rate  
1985 - 2018

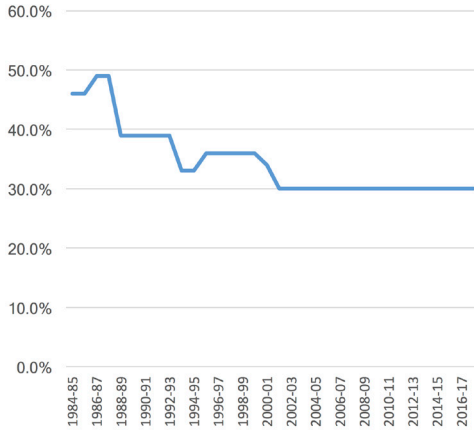
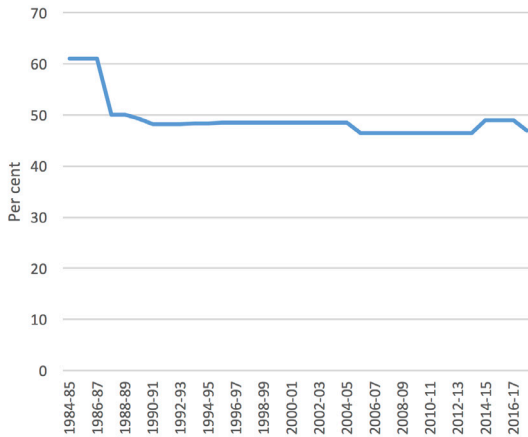


Figure 7: Personal Income Tax Top Rate  
1985- 2018



As a result of these episodes of tax reform, headline income tax rates have come down significantly, as illustrated in Figures 6 and 7. However, effective overall income tax rates have not come down as much, or at all, because reductions in headline rates have tended to

be offset by base-broadening and bracket-creep effects.<sup>20</sup> Furthermore, the Medicare levy — an additional tax applied to all personal income and in effect a second personal income tax — has already been doubled from its original rate of 1% in 1984, thereby offsetting some of the reductions in personal income tax; and is set to rise again in 2019.

In the field of indirect taxation, interestingly Australia has not followed the experience of many other countries (except Canada) that have introduced a value-added tax at a low rate and then increased it. Australia's 10% GST has not been raised since it was introduced in 2000, nor has the base been broadened. There is support among economists for increasing the rate and/or broadening the base to raise extra revenue or fund cuts in direct taxes, but community and political opposition is strong and this may help limit the overall tax burden.

Since 2010, despite attempts by two governments to restart comprehensive tax reform, little has been achieved. The personal tax-free threshold was increased in the context of a new carbon tax, which was subsequently abolished. A new and ill-conceived federal minerals resource rent tax was introduced as part of a plan to cut the corporate tax rate to 25%, but the tax was reshaped prior to implementation and then abolished in the midst of intense political controversy and the corporate rate cut was shelved. The current government has restored the policy of lowering the rate to 25% over a number of years, but this has so far been rejected by the Senate in favour of a smaller cut confined to small companies. Another recent and surprising policy change is the adoption of a tax on major bank liabilities along the lines of the bank levy in force in the UK since 2011.<sup>21</sup> There have been other tax policy changes, but mostly small to medium size changes for the purpose of raising additional revenue, usually dressed up as measures to address perceived inequities and inefficiencies.<sup>22</sup>

In summary, the tax policy changes of recent years have lacked strategic purpose and a coherent reform theme. Their main purpose has been to raise extra revenue in politically opportunistic ways to fund popular expenditure programs. Prior to the recent outbreak of tax increases, the tendency of tax policy in Australia was for increases to be imposed through the stealth policy of bracket creep while major explicit policy changes or packages of changes were usually revenue-neutral or revenue-reducing. Governments have tended towards

the cautious approach of not giving up revenue at times of chronic budget deficits. The series of personal income tax cuts implemented from 2003 to 2010 were consistent with budget surpluses at the time but have been criticised by some for handing back to taxpayers too much of what proved to be temporary surplus revenue and thereby contributing to the current budget problems. However, a stronger case can be made that the government increased spending too much in that period, and that had the tax cuts been smaller the extra revenue would have been used to fund and lock in even higher spending, not higher budget surpluses.<sup>23</sup>

Bracket creep has been muted by low inflation in recent years but is still present, gradually lifting effective personal income tax rates and undoing the benefits of earlier tax cuts. The government is relying on bracket creep as well as explicit tax increases to restore budget balance. Further tax reform is needed, but has fallen victim to the general budget malaise, which increases the political challenge of reconciling popularity with fiscal responsibility in shaping tax policy changes. As with expenditure restraint as described above, tax reform has also fallen victim to the politics of inequality and populism, which stand in the way of reductions in upper personal income tax rates and corporate income tax.

### ***5. Efficiency in resource allocation***

There have been some advances towards greater efficiency in public sector resource allocation, particularly through privatisation and corporatisation of public enterprises. Historically the federal government owned a significant number of commercial enterprises — many of them large — but most of them have been privatised since the late 1980s. These include businesses in banking, aviation, telecommunications and health services. As a result, the largest bank, airline, airport, telecommunications company, health insurance company and biotech company now listed on the Australian stock exchange were once wholly owned by the Australian government.<sup>24</sup> Their market capitalisation far exceeds what they were sold for — a fact some say demonstrates that they were sold too cheaply. However,



this criticism overlooks the substantial growth and increases in profitability these companies have achieved since being freed from government shackles, not to mention the general increase in stock market valuations.

Privatisation has undoubtedly been a plus for efficient resource allocation. It was also a plus for the public finances, as privatisation proceeds enabled governments to pay down debt and build up financial assets. However, this benefit may have dissipated over time as the reduction in net debt created more latitude to increase it again in the fiscally less favourable conditions of recent years.

Privatisation has become more unpopular and politically contentious, particularly if it involves utilities. Going against the direction of privatisation, the Labor government of 2007–13 saw fit to create a new public enterprise for the purpose of building and operating (as a monopoly wholesaler to telecommunications retailers) a national network of high-speed broadband. The successor government has continued along this path with some modifications to the details of the network — the result still being that a business segment of the previously privatised Telstra has effectively been renationalised with negotiated compensation. The NBN Company, as it is known, is receiving some \$50 billion of equity and debt funding from the government but its commercial viability remains to be proven. Official policy is ultimately to privatise the company, but it is likely to be unsaleable at least until its value is heavily written down. Recently, the Liberal-National government decided to build a second Sydney airport as a public enterprise, with the same intention of ultimately privatising it.

The NBN Company and any other business enterprises remaining in government hands (such as Australia Post) are required under the policy of corporatisation to operate as commercial entities with boards, generating profits, being subject to the same taxes as private businesses, and any subsidies from government being made explicit.

While initiatives such as privatisation and corporatisation in the government business enterprise sector have been positive for efficient resource allocation, there is less evidence of improvements in the same direction in the general government sector.

Efficiency has several dimensions: technical (the relationship between inputs and outputs); allocative (allocating resources to programs with the highest marginal benefits); and effectiveness (performance in achieving the end-objectives of programs rather than intermediate outputs).

Efficiency dividends as discussed in Section 3 above have been a feature of federal budgets for many years. However they are a blunt instrument — failing to discriminate between more and less efficient departments — and they omit large swathes of the budget such as transfer payments to individuals and to state governments. Often the efficiency dividend has been increased as a last resort when governments' appetite for program-specific cuts has been exhausted. As the focus of efficiency dividends is on inputs, the effect on efficiency is indeterminate — for example, departments may adjust to a reduction in inputs by reducing services.

The efficiency dividend is a useful tool but governments have come to expect too much of it and overused it. Nonetheless, there is no doubt that in its indiscriminate way the dividend has put some agencies under budgetary pressure and some improvement in efficiency has probably resulted. One gauge of the effect is the trend in overall staff numbers in the federal government. Excluding military personnel and reserves, average staffing levels on a full-time equivalent basis increased strongly by 30% in the nine years to 2007–08 but have since fallen by about 3% to 2016–17.<sup>25</sup>

The outcomes and outputs framework first adopted — along with accrual accounting — in 1999-2000 has been a more ambitious and potentially fruitful project in public resource management. The framework aims to shift the focus of budgeting from inputs to the end-goals or outcomes of programs (such as educational outcomes in school funding programs) and the relationship to inputs. However, the indications are that actual practice has a long way to go before the full potential of this approach to public resource management is achieved.<sup>26</sup> In politically high profile areas such as education, governments do not 'walk the talk' of outcome budgeting and continue to emphasise the amount of expenditure as the key gauge of commitment and achievement while actual educational outcomes fail

to improve. The allocation of public resources continues to be driven largely by political considerations rather than the marginal benefits of programs.

Another important initiative has been the Productivity Commission's annual reports on efficiency and effectiveness of government services, which cover both federal and state governments.<sup>27</sup> This report, which has been produced for 22 years, aims to increase transparency and accountability of government service delivery by publishing performance indicators for a wide range of programs. However, it is one thing to provide data, and another thing for governments to act on poor performance. One of the consistent themes of the Productivity Commission's reports and other studies has been the poor productivity performance in human services programs such as public hospitals.

## **6. Fiscal federalism**

Fiscal federalism needs to be canvassed here because fiscal relations between national and sub-national governments are an important determinant of economic efficiency and fiscal balance in a constitutional federation such as Australia. Unfortunately, despite false starts, reform has failed to be achieved in an area that needs it.

At least since the Second World War, the Australian federation has been characterised by a very high degree of vertical fiscal imbalance — with the states heavily dependent on central government transfers — and the central government has acquired a strong policy influence in functions constitutionally the preserve of the states. Currently the states in aggregate receive about 45% of their revenue as transfers from the federal government, divided about 50/50 between untied and tied grants. While the problems of functional overlap and duplication, confusion of accountability and prevalence of 'pass-the-buck' behaviour have been much discussed over many years, little has changed. The states have adjusted fully to a condition of financial dependency while the federal government has grown to enjoy wielding fiscal power beyond what the constitutional framers intended it to have.

The tax reforms of 1999–2000 discussed above had reform of fiscal federalism as one of its stated goals. The GST introduced in 2000, although legislated by the federal parliament and administered by the federal tax administration, was assigned in its entirety to the states in lieu of the more discretionary untied grants that had been paid up to that point. In addition, by intergovernmental agreement as the GST revenue exceeded the previous untied grants the surplus was assigned to the abolition of a group of distorting and inefficient state financial transactions such as a levy on all deposits made to financial institutions.

While these arrangements delivered greater revenue security to the states and, perhaps, more revenue than they would have received had the previous arrangements continued, they failed to deliver greater control of revenue to states either individually or collectively. The relevant GST legislation prescribes that neither the rate nor the base can be changed without unanimous agreement of federal and state parliaments. While this ‘lock’ helps explain why the GST has not been significantly changed in its 17-year existence, and for that reason may be welcomed by those generally inclined to oppose tax increases, it has the disadvantage of limiting states’ fiscal flexibility.

It should also be said that the GST lock is not binding on successive federal parliaments and could be undone by new legislation were a federal government so inclined and able to secure a majority in the upper as well as the lower house. The GST is ‘the states’ tax’, as federal ministers have often provocatively stated, only as long as the federal parliament wants it to be. Meanwhile, decades of High Court constitutional interpretation suggest that the alternative of a state-legislated GST or sales tax would not survive a constitutional challenge.

## ***7. Conclusions and key lessons***

The record of Australia’s fiscal reform looking back over the past 30 years is substantial, although it looked more impressive 10 years ago than it does now.

On the positive side, the structural budget deficit was eliminated through policy action taken in the 1980s and 1990s, before very favourable external shocks pushed the budget into surplus in the first decade of the new century. As a result, net federal debt turned negative for a few years and gross debt dipped to 5% of GDP. Federal spending alternated between periods of restraint and accelerated growth, and there was substantial tax reform with reductions in personal and corporate income tax rates, base broadening and a new goods and services tax to replace highly inefficient indirect taxes. State enterprises were transformed by privatisation and corporatisation.

As a result of these achievements, when repercussions from the northern hemisphere financial crisis hit Australia, it was in a strong fiscal position to withstand the shock.

On the negative side, a structural budget deficit has again opened up and it remains to be seen if, when and how it will be resolved. There are sharp disagreements among economists and the political parties about the appropriate pace of fiscal consolidation and whether the emphasis should be on increasing taxation or reducing spending. What is clear is that current government projections show the budget being balanced by around 2020, with both tax revenue and spending above their long-term averages as proportions of GDP. Given that outlook, and the fact that new spending programs continue to be rolled out, it is clear that the political forces favouring higher spending and taxes are edging out those favouring lower taxes. In that sense, unless there is a change of course soon, Australia is set to become more like the developed countries with bigger public sectors.

Meanwhile, the tax system — leaving aside deficit reduction considerations — remains in need of further reform. There is excessive reliance on direct taxation, with high rates of personal and corporate income tax that make it increasingly difficult for Australia to compete. Expenditure programs are also in need of reform to make them more efficient and more affordable in the long-term as the effects of population ageing build up. Both tax and expenditure reforms need to occur alongside reform of fiscal federalism, as there are major imbalances between federal and state governments and Australia is missing out on many of the benefits of competitive federalism.

Australia's experience holds lessons for other countries contemplating fiscal reform, such as:

- It takes serious problems, if not a crisis, to jolt the political system into taking corrective action.
- Temporary revenue windfalls can sap a country's fiscal strength in the longer term if they are used in ways that lock in fiscal costs.
- Getting the institutional and fiscal governance arrangements right is necessary for fiscal reform, but they won't guarantee it unless there is also the political will to act.
- Reform requires political champions who are willing to argue the case for change over and over again and stay the course in the face of strong opposition.
- Comprehensive reform is desirable but rarely achieved. Reform episodes are never complete. Some things that need to be done prove too hard and are left undone for another time.
- Victories in fiscal reform are never permanent. Backsliding can occur and the same lessons have to be learned over and over. The price of fiscal discipline is eternal vigilance. Having seemingly eradicated deficits and debt, Australia is plagued by them again now.
- Times of fiscal plenty make reform easier to achieve – because it is then that the number of losers from reform can be minimised through compensation – but also make the need appear less pressing.
- Fiscal consolidation (or 'austerity') that corrects over-spending and chronic deficits is not contractionary. To the contrary, it strengthens the foundations for economic growth — for example by relieving upward pressure on taxation, lowering uncertainty, improving business and household confidence, taking pressure off interest rates and improving international competitiveness.

- Conversely, chronic fiscal laxity such as is now evident in Australia has the opposite effects, is not expansionary and contributes to economic drift or worse.
- The forces for higher government spending have become well organised in our democratic systems while the forces for lower taxation are more disparate.

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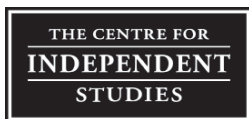
## Endnotes

- 1 For example, *A Survey of Australia: Miracle Cure – How Australia Won Economic Success*, The Economist, September 7, 2000.
- 2 Real GDP growth slowed to 1.2% and real GDP per capita fell by 0.7% in the year to 2009 Q3 and unemployment rose from 4.0% to 5.9%.
- 3 For a more complete review of the reforms, see Banks (2010).
- 4 See for example Carling and Kirchner (2012).
- 5 [http://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Budget\\_Office/role](http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/role)
- 6 The measure of the budget balance used in this paper is that defined in the federal budget (Budget 2017-18 (2017)) as the ‘underlying cash balance’, which the government has used for many years as the key measure of fiscal balance. Other measures reported in the budget are the headline cash balance (which is little different from the underlying cash balance on average over the long term, but currently exhibits a larger deficit); and the fiscal balance and net operating balance (which are accrual accounting concepts).
- 7 Seventy percent of the growth came from corporate income tax (up 14% a year) and individual income tax (up 6% a year despite large discretionary tax cuts).
- 8 This finding is confirmed by estimates of the structural budget balance in Treasury (2013) and Budget 2017-18 (2017) which suggest an average structural deficit of around 1.5% of GDP in the 15 years to 2016-17 and that the current and projected deficits are entirely structural rather than cyclical.
- 9 According to the IMF, Australia’s fiscal stimulus in 2009 – 11 totalled 5.7% of GDP, compared with an average of 5.2% for advanced G20 countries (IMF Fiscal Monitor, November 2010, p 6).
- 10 The case for fiscal stimulus in the circumstances of 2008-09 is set out in Gruen (2009), while the other side of the debate is articulated by Carling (2009) and Makin (2009).
- 11 In each year of the expenditure restraint episodes of the 1980s and the 1990s and immediately after, real GDP grew by at least 3.5%.
- 12 Total general government debt for federal and state governments combined using IMF standardised definitions is 43% (gross) and 21% (net) for 2017.
- 13 Federal net debt was negative (that is, financial assets exceeded debt) from 2007 to 2009, while gross debt fell to 5% of GDP.

- 14 Standard and Poor's placed the Commonwealth of Australia on negative outlook in July 2016, while retaining the AAA rating, signalling the agency's assessment there was a 33% chance of a downgrade within two years. That assessment was reaffirmed following the 2017 federal budget.
- 15 Since Australia is a net international borrower, infrastructure spending needs to generate a return to the economy at least above world interest rates to generate higher national income.
- 16 The IMF's internationally standardised measure is 37.3% for 2016, compared with an average of 39% for the advanced countries (IMF Fiscal Monitor, April 2017).
- 17 A recent summary of the evidence is provided by David Uren, 'Wages may have stalled but inequality is not rising in Australia', The Australian newspaper ([www.theaustralian.com.au](http://www.theaustralian.com.au)), 20 April 2017.
- 18 Major published tax reviews include the Commonwealth Taxation Review Committee (the Asprey review) (1975) which first recommended many of the reforms taken up and refined by later reviews and in some cases adopted by government; A New Tax System (1998) which led among other things to the Goods and Services Tax; Ralph Review of Business Taxation (1999) which led to the cut in corporate income tax to 30%; and Australia's Future Tax System (the Henry review) (2010).
- 19 The top marginal rate was increased to 49% in 2014 as a 'temporary budget repair levy, but was restored to 47% as scheduled in July 2017.
- 20 Corporate income tax revenue increased from around 3% of GDP to 4% as the headline rate was cut to 30%. Personal income tax revenue has declined from a peak of around 13% of GDP in the mid-1980s to around 11% currently, but is projected to increase to 12% by 2020.
- 21 The tax of 0.06% of selected liabilities of five banks takes effect on 1 July 2017 and is expected to raise about \$1.5 billion a year.
- 22 Such policy changes are small to medium relative to overall revenue but may have a large impact on the individuals affected. Examples in recent years include increased taxation on private retirement savings and earnings, increased excise duty on tobacco, curbing of various tax deductions, and resumption of indexation of fuel excise to inflation.
- 23 The case against tax increases in Australia's current situation is made by Potter (2016).

- 24 The list includes the Commonwealth Bank of Australia, Telstra, Qantas Airways, Sydney Airport, CSL (formerly Commonwealth Serum Laboratories) and Medibank Private.
- 25 Budget 2017-18, Budget Paper No 4, Agency Resourcing (Part 2: Staffing of Agencies), and prior budgets (Australian Government, Canberra, 2017).
- 26 For example, Australian National Audit Office, *Application of the Outcomes and Outputs Framework*, Audit Report No 23, 2006-07.
- 27 Productivity Commission, *Report on Government Services 2017* (Australian Government, Canberra, 2017).





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# From Reform to Retreat: 30 years of Australian fiscal policy

Australia entered an era of economic reform in the mid-1980s as policymakers resolved to liberalise the country's economy and strengthen its public finances. Fiscal reform, which is the subject of this paper, was an important part of the process. These reforms included management of the fiscal balance and public debt, tax reform, expenditure management, efficiency improvements, fiscal federalism and improvements to the institutional framework. Australia has reaped benefits ever since. There is however evidence of growing complacency and reform fatigue, including backsliding on fiscal policy. The purpose of this essay is to describe the economic and political circumstances that led to the reform path, to detail and analyse the composition of the fiscal reforms, to draw lessons from the reform experience and to reflect on the risk that much of what has been achieved will be reversed. The goal is to remind readers that hard-won fiscal reforms have been highly beneficial and that abandoning the policy course that has served the country so well for the past 30 years would be foolhardy.

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